IN THE COURT OF APPEALS OF TENNESSEE
AT NASHVILLE
October 26, 2006 Session

HEALTHCARE MANAGEMENT RESOURCES, LLC, ET AL. v. JERRY W. CARTER, ET AL.

Appeal from the Chancery Court for Davidson County
No. 04-3287 Ellen Hobbs Lyle, Chancellor

No. M2006-00058-COA-R3-CV - Filed on January 23, 2007

In 2001, defendant Michael Henry ("Henry") sold his interest in Healthcare Management Resources, LLC, (the "Company") to Jerry Carter ("Carter"), Dennis Swartz ("Swartz"), and Hal Roseman, M.D. ("Roseman"). In 2003, as part of a loan agreement with AmSouth Bank ("AmSouth"), Henry pledged certain collateral as security for a loan to the Company. Although Henry was no longer involved with the Company, he pledged the collateral because funds from the 2003 loan were to be used to pay a promissory note to Henry. Carter, Swartz, and Roseman sold their interests in the Company to various new investors in July of 2004. At the same time, AmSouth entered into a new loan with the Company. The proceeds from the 2004 loan were used to pay off the 2003 loan. Because the 2003 loan was paid off, Henry was released from his pledge of collateral. Henry did not pledge any collateral for the 2004 loan. The Company's new investors soon sued Carter, Swartz, and Roseman for fraud, centered around the sale of their ownership interests in the Company to the investors. AmSouth intervened in the lawsuit, and also sued Henry seeking to rescind the release of the collateral pledge agreement. There are no allegations of fraud made against Henry. The Trial Court dismissed AmSouth's claims against Henry after finding the complaint failed to state a claim upon which relief could be granted as to Henry. AmSouth appeals. We affirm.

Tenn. R. App. P. 3 Appeal as of Right; Judgment of the Chancery Court Affirmed; Case Remanded

D. MICHAEL SWINEY, J., delivered the opinion of the court, in which CHARLES D. SUSANO, JR., and SHARON G. LEE, JJ., joined.

Roger G. Jones and Austin L. McMullen, Nashville, Tennessee, for the Appellant, AmSouth Bank.

Robert J. Mendes and Janna Eaton Smith, Nashville, Tennessee, for the Appellee, Michael Henry.

OPINION

Background

Healthcare Management Resources, LLC, is a limited liability company organized under the laws of Tennessee with its principal place of business in Tennessee. The Company provides management services to hospitals. Henry had an ownership interest in the Company until 2001, at which time he sold his interest to Carter, Swartz, Roseman. In December of 2001, AmSouth Bank ("AmSouth") made two loans to the Company, which consisted of a $5 million term loan and a revolving line of credit not to exceed $1.5 million.

On December 31, 2003, AmSouth and the LLC entered into an amended and restated loan agreement (the "2003 Loan Agreement"). Although Henry was no longer a member of the Company's management staff and no longer had any ownership interest in the Company, Henry nevertheless pledged collateral to AmSouth as security for the 2003 Loan Agreement. Henry's pledging of the collateral allowed the LLC to pay off a promissory note to Henry with a portion of the funds from the 2003 Loan Agreement. The amount of the 2003 Loan Agreement was $5,081,691.24, with a line of credit not to exceed $1.5 million. In the Pledge Agreement signed by Henry, he pledged $815,000 in collateral. In addition, Carter, Swartz, and Roseman all signed individual Guaranty Agreements.

On July 4, 2004, Carter, Swartz, and Roseman transferred control of the LLC to various new investors. As part of this transfer, it was agreed that the LLC would redeem the membership interests of Carter, Swartz, and Roseman. In addition and also as part of the sale, AmSouth and the LLC entered into another amended and restated loan agreement (the "2004 Loan Agreement"). Henry did not pledge any collateral as part of the 2004 Loan Agreement and he was not a signatory to that agreement. The 2003 Loan Agreement was paid in full from the proceeds of the 2004 Loan Agreement. The 2004 Loan Agreement provides:

> (d) Purpose. The purpose of the Term Loan is to pay and retire on the date hereof the indebtedness of the Borrower to the Lender evidenced by that certain Promissory Note (Term Loan) dated December 31, 2003.

Because the 2003 Loan Agreement was paid in full, albeit with funds obtained from the 2004 Loan Agreement, AmSouth, Henry, Carter, Swartz, and Roseman all executed agreements which released Carter, Swartz, and Roseman from their personal guaranties, and released Henry from the collateral pledge agreement.

The LLC and the new investors defaulted on the 2004 Loan Agreement and AmSouth entered into a forbearance agreement with the LLC. The litigation now before us began in November of 2004, with a complaint being filed by the new investors of the LLC. The investors sued Carter, Swartz, and Roseman asserting fraud, breach of contract, breach of warranty, unjust

enrichment, and conversion. According to the complaint, Carter, Swartz, and/or Roseman "made false and fraudulent representations and warranties to induce the Investors to invest in the LLC at an inflated valuation and to induce the LLC into redeeming their shares at an inflated value."

AmSouth intervened in the lawsuit and also sued Carter, Swartz, and Roseman. AmSouth also sued Henry. AmSouth's complaint primarily asserted claims of fraud and unjust enrichment. With regard to the claims against Henry, AmSouth sought to rescind the release given to Henry of the collateral pledge agreement. AmSouth also sought to rescind the release of the personal guaranties that had been made by Carter, Swartz, and Roseman. As grounds for its fraud and unjust enrichment claims, AmSouth alleged various acts of fraud by Carter, Swartz, and/or Roseman.

Henry filed a motion to dismiss AmSouth's complaint as to him primarily on the basis that AmSouth did not allege any fraudulent conduct by Henry. Following a hearing on the motion to dismiss, the Trial Court entered an order stating as follows:

> 1. The Complaint filed by AmSouth Bank does not state a cause of action for fraud or unjust enrichment as to Defendant Henry. Therefore, AmSouth Bank's claims for fraud and unjust enrichment as to Defendant Henry are dismissed.
>
> 2. The Complaint filed by AmSouth Bank does state a cause of action against Defendant Henry for rescission of the Release Agreement based on AmSouth Bank's allegations that the representations and warranties made by parties other than Defendant Henry and contained in the documents delivered to AmSouth Bank in connection with the Release Agreement were false.
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> 3. AmSouth Bank is directed to file an Amended Complaint reflecting the dismissal of its fraud and unjust enrichment claims against Defendant Henry and clarifying that AmSouth Bank Seeks rescission of the Release Agreement as to Defendant Henry based on AmSouth Bank's allegations that the representations and warranties made by the parties other than Defendant Henry and contained in the documents delivered to AmSouth Bank in connection with the Release Agreement were false.

After this order was entered and pursuant to the directives contained in that order, AmSouth filed a motion to amend the complaint to add a claim against Henry seeking rescission based on false representations made by defendants other than Henry. In the proposed amended complaint, AmSouth sought rescission of the release or, in the alternative, compensatory damages.

The Trial Court then reconsidered whether AmSouth could state a cause of action against Henry for rescission based upon representations and warranties made by other defendants. The Trial Court then reversed its previous order and entered a new order stating:

> The Motion for Leave to Amend is denied based upon the failure of AmSouth Bank to state a claim against Henry in the Proposed Amended Complaint and based upon the Court's ruling that the amendment of AmSouth Bank's Complaint would be futile.
>
> Therefore, based upon the failure of AmSouth Bank to successfully state a claim against Henry in its Complaint and Proposed Amended Complaint and the futility of any amendment to the Complaint, the claims filed by AmSouth Bank against Henry are dismissed with prejudice.

The Trial Court certified its order dismissing all of AmSouth's claims against Henry as a final and appealable order, and this appeal followed. On appeal, AmSouth argues the Trial Court erred in dismissing its claims of fraud and unjust enrichment against Henry. AmSouth argues that it has stated a claim upon which relief can be granted for rescission of the agreement wherein AmSouth released Henry from the collateral pledge agreement.[1]

Discussion

Our standard of review as to the granting of a motion to dismiss is set out in *Stein v. Davidson Hotel Co.*, 945 S.W.2d 714 (Tenn. 1997). In *Stein*, our Supreme Court explained:

> A Rule 12.02(6), Tenn. R. Civ. P., motion to dismiss for failure to state a claim upon which relief can be granted tests only the legal sufficiency of the complaint, not the strength of a plaintiff's proof. Such a motion admits the truth of all relevant and material averments contained in the complaint, but asserts that such facts do not constitute a cause of action. In considering a motion to dismiss, courts should construe the complaint liberally in favor of the plaintiff, taking all allegations of fact as true, and deny the motion unless it appears that the plaintiff can prove no set of facts in support of her claim that would entitle her to relief. *Cook v. Spinnaker's of Rivergate, Inc.*, 878 S.W.2d 934, 938 (Tenn. 1994). In considering this appeal from the trial court's grant of the defendant's motion to dismiss, we take all allegations of fact in the plaintiff's complaint as

[1] AmSouth's brief also states as an issue that the Trial Court erred when it refused to allow AmSouth to amend its complaint on the basis that the amendment would be futile. This issue is not addressed by AmSouth in the argument section of its brief. Accordingly, we will treat that issue as having been abandoned by AmSouth.

> true, and review the lower courts' legal conclusions *de novo* with no presumption of correctness. Tenn. R. App .P. 13(d); *Owens v. Truckstops of America*, 915 S.W.2d 420, 424 (Tenn. 1996); *Cook, supra*.

Stein v. Davidson Hotel Co., 945 S.W.2d 714, 716 (Tenn. 1997).

At the outset, it is important to emphasize that this appeal does not involve any of the claims or potential remedies AmSouth may have against defendants Carter, Swartz, or Roseman. This appeal involves only whether AmSouth has stated a claim against Henry. We express absolutely no opinion as to any of the claims by the various plaintiffs against Carter, Swartz, or Roseman.

We first will discuss AmSouth's claim against Henry for fraud. Tenn. R. Civ. P. 9.02 provides as follows:

> In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally.

Very recently, in *Kincaid v. SouthTrust Bank*, No. M2005-00121-COA-R3-CV, 2006 WL 3093226 (Tenn. Ct. App. Oct. 31, 2006), *perm. app. pending*, we were confronted with a similar situation. Specifically, the complaint in that case set forth numerous specific factual allegations supporting a fraud claim against one of the defendants, Ed Street, but not two others defendants, those defendants being SouthTrust Bank and SC Realty. This Court upheld the trial court's Tenn. R. Civ. P. 12.02(6) dismissal of the fraud claims against SouthTrust Bank and SC Realty, stating:

> Plaintiffs' third claim for relief alleges actual fraud against SouthTrust and SC Reality. The elements of fraud are: (1) an intentional misrepresentation of a material fact, (2) knowledge of the representation's falsity, (3) an injury caused by reasonable reliance on the representation, and (4) the requirement that the misrepresentation involve a past or existing fact. *Dobbs v. Guenther*, 846 S.W.2d 270, 274 (Tenn. Ct. App. 1992) (citations omitted).
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> * * *
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> As we observed earlier, the first 87 paragraphs of the Complaint are replete with particular and specific facts regarding the actions of Ed Street and his alleged misrepresentations of material facts. The Complaint, however, is grossly lacking with respect to

> specific material misrepresentations of facts by SouthTrust or SC Realty.
>
> Allegations of fraud must be plead with particularity. Tenn. R. Civ. P. 9.02; *Strategic Capital Resources, Inc. v. Dylan Tire Industries, LLC*, 102 S.W.3d 603, 611 (Tenn. Ct. App. 2002). A claim of fraud is deficient if the complaint fails to state with particularity an intentional misrepresentation of a material fact. *See Dobbs*, 846 S.W.2d at 274. Plaintiffs allege, "each one of the Defendants did the acts herein alleged with the intent to deceive and defraud …" and "herein" refers generally to one hundred paragraphs. To pass the particularity test, the actors should be identified and the substance of each allegation should be pled. *Strategic Capital Res., Inc. v. Dylan Tire Indus., LLC*, 102 S.W.3d 603, 611 (Tenn. Ct. App. 2002). That was not done here.
>
> Plaintiffs set forth numerous and significant allegations of particular facts alleging intentional misrepresentations of material facts, which are sufficient to support a claim of fraud; however, almost all of them pertain to misrepresentations by Ed Street, not SouthTrust Bank or SC Realty. Since Street was not an agent of either defendant, his acts are not attributable to them. After separating the alleged material misrepresentations attributable to Street, we find the remaining allegations insufficient to sustain a claim of fraud against Defendants.
>
> The Complaint simply fails to identify with particularity facts sufficient to sustain a claim of fraud as it pertains to SouthTrust or SC Realty.

Kincaid, 2006 WL 3093226, at **7 - 8.

In the present case, AmSouth does not allege any facts that would support a fraud claim against Henry. All of the allegations of fraud discuss alleged fraudulent representations made by defendants other than Henry. The fraud claim asserted against Henry is nothing more than a conclusory allegation and runs afoul of the requirements of Tenn. R. Civ. P. 9.02. Accordingly, the Trial Court correctly determined that AmSouth failed to state a claim for fraud upon which relief could be granted against Henry.

AmSouth's next claim is that Henry was unjustly enriched. In *Bennett v, Visa U.S.A., Inc.*, 198 S.W.3d 747 (Tenn. Ct. App. 2006), we stated the following with regard to claims of unjust enrichment:

> Both unjust enrichment and money had and received are essentially the same cause of action, being both quasi-contractual actions. The Tennessee Supreme Court recently discussed the elements of an unjust enrichment claim as follows:
>
> > The elements of an unjust enrichment claim are: 1) "[a] benefit conferred upon the defendant by the plaintiff"; 2) "appreciation by the defendant of such benefit"; and 3) "acceptance of such benefit under such circumstances that it would be inequitable for him to retain the benefit without payment of the value thereof." The most significant requirement of an unjust enrichment claim is that the benefit to the defendant be unjust. The plaintiff must further demonstrate that he or she has exhausted all remedies against the person with whom the plaintiff enjoyed privity of contract.
> >
> > A plaintiff need not be in privity with a defendant to recover under a claim of unjust enrichment.… [A] plaintiff need not establish that the defendant received a direct benefit from the plaintiff. Rather, a plaintiff may recover for unjust enrichment against a defendant who receives any benefit from the plaintiff if the defendant's retention of the benefit would be unjust.
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> *Freeman Indus. v. Eastman Chem. Co.*, 172 S.W.3d 512, 525 (Tenn. 2005) (citations omitted) (quoting *Paschall's, Inc. v. Dozier*, 219 Tenn. 45, 407 S.W.2d 150, 155 (1966)). "[T]o maintain an action for unjust enrichment, a plaintiff is not required to exhaust all remedies against the party with whom the plaintiff is in privity if the pursuit of the remedies would be futile." *Id*. at 526.

Bennett, 198 S.W.3d at 755-56 (footnote omitted).

When the 2003 Loan Agreement was paid in full by the 2004 Loan Agreement, AmSouth was required by the 2003 Loan Agreement to release Henry from the collateral pledge agreement. This effectively removed Henry from the picture. Henry was no longer a member of the Company's management and no longer had any ownership interest in the company, and had not for several years. The 2003 Loan Agreement had been paid in full, and the collateral pledge agreement, Henry's last tie to the LLC, was released. Henry was not a signatory or otherwise involved with the 2004 Loan Agreement or the alleged misrepresentations AmSouth claims were made prior to the execution of that agreement. AmSouth received ample consideration for releasing Henry from the collateral pledge agreement, *i.e.*, payment in full of the 2003 Loan Agreement. There are absolutely no factual allegations of improper or fraudulent actions by Henry at any time, including when the

2003 and 2004 Loan Agreements were entered into. Under these facts, there is absolutely nothing unjust or inequitable about Henry remaining released from the collateral pledge agreement. When construing the complaint liberally in favor of AmSouth, and taking all allegations of fact as true, AmSouth can prove no set of facts in support of its claim that would entitle it to relief on a claim of unjust enrichment *against Henry*. *See Stein*, 945 S.W.2d at 716.

AmSouth's only request for relief as to Henry is rescission of the release of the collateral pledge agreement. Henry asserts that AmSouth can prove no set of facts entitling AmSouth to the equitable remedy of rescission, relying in part on *Alden Auto Parts Warehouse, Inc. v. Dolphin Equipment Leasing Corp.*, 682 F.2d 330 (2nd Cir. 1982). In *Alden Auto*, the plaintiff, Alden Auto Parts Warehouse, Inc., and the defendant, Dolphin Equipment Leasing Corporation, were both victims of fraud by a third party, Intertel Communications Corp. The Second Circuit stated:

> Although a contract entered into because of a *mutual* mistake of material fact will generally be avoidable, 37 N.Y. Jur., *Mistake, Accident, or Surprise* § 5 (1964), a unilateral mistake standing alone usually does not justify equitable relief, *id*. § 7; Restatement of Restitution, *supra*, § 12 ("A person who confers a benefit upon another, manifesting that he does so as an offer of a bargain which the other accepts or as the acceptance of an offer which the other has made, is not entitled to restitution because of a mistake which the other does not share and the existence of which the other does not know or suspect."). The fact that Alden was led into its mistake by Intertel's fraud does not give Alden a right to rescission against Dolphin since the latter was in no way a party to the fraud. *See* Restatement of Restitution, *supra*, § 28. Even focusing solely on Alden's 1978 dealings with Intertel and accepting Alden's assertion that it believed it was merely signing a document designed to assist Intertel in obtaining new financing, Alden would have no right to restitution against Dolphin, since "recovery is ordinarily denied as against a third person who, as a result of a mistake in a transaction between two other persons, receives a payment from one of them in good faith in the ordinary course of business and for a valuable consideration." 50 N.Y.Jur., *Restitution and Implied Contracts* § 22 (1966); Restatement of Restitution, *supra*, § 14 and comment d. Valuable consideration, of course, may consist of the third party's payment to either party to the contract at issue. *See id*. illustration 9 ("By fraud A obtains an I.O.U. from B. A sells this to C who pays value and has no reason to know of the fraud. Without further information, C presents the I.O.U. to B who pays. B is not entitled to restitution from C.").

> A request for rescission and restitution is addressed to the equity powers of the court, *e.g.*, *Abner M. Harper, Inc. v. City of Newburgh*, 159 A.D. 695, 699-700, 145 N.Y.S. 59, 63-64 (2d Dep't 1913), and if that request is premised on a unilateral mistake such relief will normally not be granted if the defendant, by reason of changed circumstances or otherwise, will be prejudiced thereby, *e.g.*, *id.*, 159 A.D. at 697, 145 N.Y.S. at 62; *Harding v. Knapp*, 8 N.Y.S.2d 224, 227 (City Ct. Roch. 1938); Restatement of Restitution, *supra*, §§ 69, 142.

Alden, 682 F.2d at 333. *Cf. Brandon v. Wright*, 838 S.W.2d 532, 534 (Tenn. Ct. App. 1992)("Fraud renders all contracts void, ab initio, at the option of the defrauded party, when diligently exercised, *and in the absence of intervening rights of innocent third parties*. *Richardson v. Vick*, 125 Tenn. 532, 145 S.W. 174 (1910)." (emphasis added).

In *Richards v. Taylor*, 926 S.W.2d 569 (Tenn. Ct. App. 1996), this Court observed that the remedy of rescission:

> 'should be exercised sparingly and only when the situation demands such.' *James Cable Partners v. Jamestown*, 818 S.W.2d 338, 343 (Tenn. App. 1991). We have held that 'rescission of a contract is not looked upon lightly. It is available only under the most demanding circumstances.' *Robinson v. Brooks*, 577 S.W.2d 207, 208 (Tenn. App. 1978). Among the few grounds justifying rescission are fraud and undue influence …. *See Birdsong v. Birdsong*, 39 Tenn. 289 (Tenn. 1859). The appellate courts of this state have held on numerous occasions that, generally speaking, inadequacy of consideration, unconnected with fraud or undue influence, is not a sufficient cause to rescind a contract. *Coffee v. Ruffin*, 44 Tenn. 487 (Tenn. 1867); *Pipkin v. Lentz*, 49 Tenn. App. 206, 354 S.W.2d 87 (Tenn. App. 1961). In *Hardeman v. Burge*, the Supreme Court stated that "before a court of chancery can rescind a contract for inadequacy of consideration, it must be gross and shocking, such as is equivalent to proof of fraud in the transaction." 18 Tenn. 202, 204 (Tenn. 1836). It has also been held that if an adequate remedy at law exists, such as an award of damages, rescission will not be granted. *Chastain v. Billings*, 570 S.W.2d 866 (Tenn. App. 1978).

Richards, 926 S.W.2d at 571-72.

We agree with the rationale of the Second Circuit in *Alden Auto* and the Trial Court in the present case. AmSouth has not cited us to any authority which would allow AmSouth to seek rescission against an innocent third party based on the fraudulent conduct of someone else. Stated

another way, the alleged fraud committed by Carter, Swartz, and/or Roseman surrounding the 2004 Loan Agreement cannot form the basis for AmSouth to rescind a separate agreement with Henry, an innocent third party, which released Henry from a collateral pledge agreement which was part of the 2003 Loan Agreement.

Richards also leads us to AmSouth's next issue, which is its claim that it should be allowed to rescind the release of Henry's pledge agreement due to the failure of consideration. AmSouth argues:

> [T]he falsity of the financial statements, representations and warranties [made by Carter, Swartz, and/or Roseman] completely defeated the consideration AmSouth received from the Defendants in the July 4, 2004 transaction.

This argument overlooks the fact that Henry was not a party to the 2004 Loan Agreement. If there was a failure of consideration, then it was to that 2004 agreement, not the 2003 Loan Agreement. There was adequate consideration with the 2003 Loan Agreement and Henry's collateral pledge agreement. The 2003 Loan Agreement was paid in full, and it was the terms of the pledge agreement entered into as part of the 2003 Loan Agreement that required AmSouth to release Henry from that pledge. It was the payment of the 2003 Loan Agreement that triggered AmSouth's obligation to release Henry from the collateral pledge agreement, regardless of the origin of those funds used to retire the 2003 loan. Although we need not decide whether there actually was a failure of consideration, if there was such a failure, it was the consideration for the 2004 Loan Agreement that failed, not the 2003 loan. Accordingly, the Trial Court correctly determined that AmSouth failed to state a claim that would entitle it to rescission of the release of Henry's collateral pledge agreement.

When construing the complaint against Henry liberally in favor of AmSouth and taking all factual allegations as true, we find no error in the Trial Court's determination that AmSouth failed to state a claim upon which relief could be granted as to Henry. We, therefore, affirm the judgment of the Trial Court.

Conclusion

The judgment of the Trial Court is affirmed, and this cause is remanded to the Trial Court for collection of the costs below. Costs on appeal are taxed to the Appellant, Amsouth Bank, and its surety.

D. MICHAEL SWINEY, JUDGE